



Policy Research Perspectives

Review of: The Long-Term Outlook for Health Care Spending

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Health care spending continues to grow as a share of the nation's output, straining household and government budgets, and raising questions about the long-term sustainability of our current health care system. Spending on health care accounted for 16.0% of gross domestic product (GDP) in the US in 2006, up from 13.8% in 2000 and 7.2% in 1970. If health spending continues to outpace economic growth, it will eventually reach unsustainable levels. Assuming that health spending growth slows (but continues to exceed growth in the economy), the Congressional Budget Office (CBO) projects that health care spending would account for 49% of GDP in 2082. Medicare and Medicaid alone would account for 19% of GDP in that year. These are the results from CBO's November 2007 report "The Long-Term Outlook for Health Care Spending," which will likely lend support to those calling for health care reform.

Study Methods

Adjusted for inflation, health care spending growth averaged more than 5% per year from 1975 to 2005 compared to just over 3% annual growth for the US economy. The difference is roughly defined as "excess cost growth," which is key to CBO's projections. For 2007-2018, CBO's projections are consistent with those from their traditional budget baseline which assumes that excess cost growth remains at the 1975-2005 historical rate of about 2%. Health care spending is projected to grow to more than 20% of GDP by 2018. After that point, excess cost growth is assumed to decline, but would remain positive. That is, health care spending growth would exceed US economic growth throughout the 75 year projection period.

The mechanism by which excess cost growth slows is somewhat novel. Consistent with their budget and baseline projections, CBO assumes no changes in current federal law. Instead, they assume that health care spending growth will slow when it starts to crowd out or replace household consumption. That is, consumers and the private sector are assumed to react in some way to reduce health spending to prevent their real or inflation-adjusted spending on other (non-health) goods and services from declining.

CBO accounts for the aging of the population in their health care spending projections. However, this factor has relatively little impact over the long term. Aging accounts for about 25% of CBO's projected increase in Medicare and Medicaid spending through 2030, but only about 10% of such growth through 2082. The key factor behind the projected rise in health spending is excess cost growth, not the aging of the population.

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Of particular interest to physicians is a set of projections that eliminate the projected cuts in Medicare physician payment that will occur under the Sustainable Growth Rate (SGR) formula. Medicare actuaries predict that reimbursement cuts will total more than 40% through 2016, but Congress has blocked all but one of these cuts from occurring. How would projected health care spending be affected if Medicare physician pay were instead updated every year to keep pace with medical practice inflation? Although CBO has estimated that such a change would increase net federal spending by more than \$250 billion over 10 years, when considered in the broader context of overall health care spending, this change “has only a minor effect over the long term” on growth in projected spending as a share of GDP.

Comment

Projecting health spending over a 75 year period is a highly speculative exercise. Even small changes in assumptions can have a large influence on the results. CBO uses the rate of excess cost growth from 1975 to 2005 of about 2% in their projections as the initial rate of excess cost growth. More recently the gap between health spending and GDP growth has narrowed. From 1996 to 2006, health spending growth exceeded US economic growth by about 1.5 percentage points per year, and that difference has diminished over the last few years, with health spending stable at about 16% of GDP since 2003. For Medicare spending in particular, CBO’s results are markedly worse than those from the Medicare actuaries who predict that Medicare will account for about 11% of GDP in 75 years compared to about 16% for CBO.

Regardless of the particular assumptions though, if health care spending continues to grow faster than the economy it will place an increasing and likely unsustainable burden on federal, state and local governments, consumers and businesses. It is clear current trends cannot continue indefinitely, but much less clear exactly what will happen to curb the trend.